

**KANSAS DEPARTMENT OF CREDIT UNIONS**

**INVESTMENT GUIDELINES**

Effective: January 1, 1998  
Guidelines

Supersedes: Investment

Issued August 1, 1994

1. Authority: These Guidelines are issued by the Administrator, Kansas Department of Credit Unions pursuant to K.S.A. 17-2204a(c).
2. Scope: These Guidelines apply to all Kansas chartered credit unions except corporate credit unions.
3. Subject to the limitations and conditions stated in these Guidelines and any other statutory limitations imposed by the Kansas Credit union Act, the following are determined to constitute "Investment Securities":
  - a. Investments authorized by K.S.A. 17-2204 and K.S.A. 17-2204(a);
  - b. Obligations issued by:
    - (i) Federal Home Loan Banks;
    - (ii) The Federal Housing Finance Board;
    - (iii) Any wholly owned Government corporation listed in section 9101 of Title 31 of the United States Code; and
    - (iv) the Student Loan Marketing Association;
  - c. Obligations, participations, or other instruments of or issued by or fully guaranteed as to principal and interest by:
    - (i) the Federal National Mortgage Association;
    - (ii) the Government National Mortgage Association;
    - (iii) the Federal Home Loan Mortgage Corporation;
    - (iv) any agency of the United States;
  - d. Participation interests in trusts which are created by an agency of the United States and/or which an executive department, agency or instrumentality of the United States is the trustee;
  - e. The following obligations of insured credit unions:
    - (i) shares;
    - (ii) share certificates;

- (iii) deposits; and
    - (iv) federal funds;
  - f. Securities offered and sold pursuant to section 4(5) of the Securities Act of 1933 (15 USC 77d(5));
  - g. Securities that are “mortgage related securities” as defined in section 3(a)(41) of the Securities Exchange Act of 1934 (15 USC 78c(a)(41));
  - h. Subject to the conditions in Section 5, the following obligations of banks or branches of banks that are insured by the Federal Deposit Insurance Corporation or its successors:
    - (i) federal funds;
    - (ii) deposits in a foreign branch of a domestic bank;
    - (iii) deposits in domestic branches of foreign banks; and
    - (iv) banker’s acceptances;
    - (v) deposit notes; and
    - (vi) bank notes;
  - i. Investments in mutual funds or other investment companies which are registered as such with the Securities and Exchange Commission, and investments in a collective investment fund maintained by a national bank if the prospectus or offering materials of the investment company or fund restricts its investment portfolio to investments that constitute Investment Securities as specified in these Investment Guidelines and to investment transactions authorized by the Kansas Credit Union Act and these Investment Guidelines;
  - j. Other investments, not constituting Investment Securities, which are eligible investments for a Federal credit union participating in a National Credit Union Administration approved pilot program, if the credit union obtains the written approval of the Administrator.
4. Investment Transactions: Subject to the conditions in Section 5, a credit union may engage in the following types of investment transactions involving Investment Securities:
- a. repurchase agreements;
  - b. reverse repurchase agreements;
  - c. securities lending.
5. Limitations and Conditions: Each Kansas chartered credit union is expected to operate in a safe and sound manner in connection with the purchase or

sale of Investment Securities as defined in these Guidelines. Accordingly the Administrator's determination that the investments specified in these Guidelines constitute Investment Securities is conditioned upon a credit union complying with the following:

- a. Limitations, if any, imposed by the Kansas Credit Union Act;
- b. Limitations established in these Investment Guidelines;
- c. The board of directors establishing and reviewing, at least annually, written investment policies which address, at a minimum the following:
  - (i) permissible types of Investment Securities, including limitations, if any, by amount, issuer, concentration, liquidity risk, and credit risk;
  - (ii) limitations on investment operations and activities with respect to Investment Securities so that additional special reserves for nonconforming investments required by section 741.3(a)(3) of the National Credit Union Administration's Rules and Regulations would not be required;
  - (iii) identification of permissible Investment Securities authorized by the board of directors for which additional special reserves are required by section 741.3(a)(3) of the National Credit Union Administration's Rules and Regulations and any limitations applicable to such investment securities other than those limitations required by subsection (i) above;
  - (iv) policies and procedures for obtaining one or more prices on Investment Securities or for the determination of the market yield on a comparable term investment with a comparison to the yield on the Investment Security to be bought or sold, prior to the purchase or sale of the Investment Security;
  - (v) If variable rate investments meeting the requirement of Section 5(i) of these Investment Guidelines are an authorized investment for the credit union, the investment policies shall specify all approved interest rate indices.
- d. Investment or deposits in financial institutions other than corporate credit unions specified in K.S.A. 17-2204(c)(1), are limited as follows:
  - (i) a credit union may maintain a checking account and any required clearing balance in a bank without limit. Provided however, that if the amounts maintained pursuant to this subsection are in excess of the limits of applicable deposit insurance, the credit union shall conduct, document and update at least annually a credit analysis of the bank;
  - (ii) a credit union may make deposits and purchase Investment Securities of any eligible financial institution so long as the aggregate amount of such deposits and Investment Securities, when added to

amounts, if any, maintained in such institution pursuant to subsection (i) of this section (d) do not exceed the limit of applicable deposit insurance;

- (iii) In addition to amounts authorized pursuant to subsections (i) and (ii) of this section (d), a credit union may make deposits in and purchase Investment Securities of an eligible financial institution if the financial institution has an institutional rating of B/C or higher by an SEC recognized rating agency and the credit union has conducted and documents a credit analysis of the financial institution prior to the purchase and updates the analysis at least annually as long as the credit union holds the investment.

e. Obligations of eligible financial institutions are subject to the following limitations:

(i) Certificate of Deposit ("CD")

- (A) a CD must either be an "Account CD", a "CD Entitlement", or a CD in physical form. An "Account CD" is a certificate of deposit issued directly from the issuing financial institution to the credit union where the credit union is shown on the books and records of the issuing financial institution as the owner of the CD. An Account CD may either be in physical or book entry form. A "CD Entitlement" is the rights of a credit union against its safekeeping agent to a certificate of deposit purchased by the credit union and issued in book entry form by the issuing institution which certificate of deposit is part of a master certificate of deposit held by Depository Trust Company and reflected on the books of the credit union's safekeeping agent as owned by the credit union;
- (B) a CD is a contract of deposit evidencing a deposit relationship between the issuing institution and the credit union. A credit union must have and retain, until the examination by the KDCU following the maturity of any CD, a written document of the issuing institution specifying the terms and conditions of the contract of deposit applicable to the CD. A confirmation of purchase evidences a contract of sale but does not constitute a written contract of deposit unless it contains all of the terms and conditions of the issuing institution applicable to the CD;
- (C) In order for a CD to be an Investment Security and a legal investment for a credit union, the credit union must own an undivided interest in the CD which it purchases. Accordingly, a participation interest in a jumbo CD is not an Investment Security and therefore not a legal investment for a credit union, even if the credit union's participation interest in the CD may be insured; and
- (D) A CD in physical form or an Account CD may be held either by the credit union or by a safekeeping agent meeting the

requirements of Section 6 of these guidelines. A CD Entitlement may only be held in safekeeping by a safekeeping agent meeting the requirement of Section 6 of these guidelines.

(ii) Deposit Notes

- (A) In order for a Deposit Note to be a legal investment, it must be an investment rated deposit liability of a bank, not a bank holding company and have a rating no lower than A or equivalent by an SEC recognized rating agency. In addition, A Deposit Note must either be an "Account Deposit Note," a "Deposit Note Entitlement," or a Deposit Note in physical form. An "Account Deposit Note" is issued directly from the issuing financial institution to the credit union where the credit union is shown on the books and records of the issuing financial institution as the owner of the Deposit Note. An Account Deposit Note may either be in physical or book entry form. A "Deposit Note Entitlement" is the rights of a credit union against its safekeeping agent to a Deposit Note purchased by the credit union and issued in book entry form by the issuing institution which deposit notes is part of a master deposit note held by Depository Trust Company and reflected on the books of the credit union's safekeeping agent as owned by the credit union;
- (B) A Deposit Note is a contract of deposit evidencing a deposit relationship between the issuing institution and the credit union. A credit union must have and retain, until the examination by the KDCU following the maturity of any Deposit Note, a written document of the issuing institution specifying the terms and conditions of the contract of deposit applicable to the Deposit Note. A confirmation of purchase evidences a contract of sale but does not constitute a written contract of deposit unless it contains all of the terms and conditions of the issuing institution applicable to the Deposit Note;
- (C) In order for a Deposit Note to be an Investment Security and a legal investment for a credit union, the credit union must own an undivided interest in the Deposit Note which it purchases. Accordingly, a participation interest in a jumbo Deposit Note is not an Investment Security and therefore not a legal investment for a credit union, even if the credit union's participation interest in the Deposit Note may be insured; and
- (D) A Deposit Note in physical form or an Account Deposit Note may be held either by the credit union or by a safekeeping agent meeting the requirements of Section 5 of these guidelines. A Deposit Note Entitlement may only be held in safekeeping by a safekeeping agent meeting the requirement of Section 6 of these guidelines.

(iii) Bank Notes

- (A) A Bank Note is a direct, unconditional, and unsecured general obligation of a bank, not a bank holding company, that ranks equally with all other senior unsecured indebtedness of the bank, except deposit liabilities and other obligations that are subject to any priorities or preferences. A Bank Note, or the issuing bank thereof, must have a rating of at least AA or equivalent from a SEC recognized rating agency;
  - (B) A Bank Note must have an original weighted average maturity of less than five years;
  - (C) A Bank Note is subject to the same limitations on form or type as Deposit Notes specified in 5(e)(ii) of these Investment Guidelines.
- f. Investments in obligations of or issued by any state or political subdivision thereof, including any agency, corporation or instrumentality thereof are limited to those obligations that have a rating of AA (or equivalent) or better by an SEC recognized rating agency at the time of purchase and when reviewed annually thereafter;
- g. No investment security may be purchased on margin;
- h. Investment Securities purchased by a credit union must be held in the name of the credit union or in street name and must either be in the credit union's possession or held in safekeeping by a safekeeping agent meeting the requirements of Section 6 of these guidelines;
- i. If the interest rate on a variable rate investment is tied to an index, the index must be a U.S. domestic interest rate index, including a U.S. dollar-denominated London Interbank Offered Rate (LIBOR) index. Indexes based on foreign currencies or interest rates, commodity prices or equity prices are not permitted.
- j. Securities lending transactions are permitted subject to the following conditions:
  - (i) The credit union receives a written confirmation of each loan;
  - (ii) Any collateral received is a legal investment for a Kansas credit union; the credit union has a perfected first priority security interest in the collateral; and the credit union receives a daily report of the market value of the collateral, including accrued interest which market value shall be in excess of the market value of the loaned security;
  - (iii) Any cash collateral is subject to the borrowing limit of K.S.A. 17-2215 and any collateral purchased with such cash is a legal investment for

- a Kansas credit union with a maturity date no later than the maturity of the securities loan; and
  - (iv) The credit union has executed a written loan and security agreement with the borrower.
- 6. A credit union purchasing, or otherwise acquiring Investment Securities for which it does not maintain possession, shall comply with the following requirements for safekeeping :
  - a. Investment Securities owned by and not in the possession of the credit union must be held in safekeeping pursuant to a written safekeeping agreement;
  - b. Each safekeeping agent for a credit union must be approved by the board of directors. The board of directors is responsible for the review of the financial condition, at least annually, of each authorized safekeeping agent;
  - c. The safekeeping agent must be either a corporate credit union, a bank, or a trust company and must provide an account statement reflecting all activity in the account no less frequently than monthly;
  - d. The safekeeping agreement must, at a minimum, provide that:
    - (i) the safekeeping agent keep the Investment Securities that are subject to the safekeeping agreement segregated from assets of the safekeeping agent; and
    - (ii) the safekeeping agent must maintain records which reflect the identity of the credit union for whom each Investment Security is held in safekeeping.
- 7. Selection of Securities Dealers. Credit unions should only engage in the purchase or sale of securities with securities dealers about whom they have sufficient information and knowledge. The board of directors is responsible to ensure that minimum requirements are established. Minimum requirements include complete and timely review of the dealer's financial condition. This information should be gathered from current financial data, annual reports, credit reports, and other sources of financial information.

Other information should include the dealer's general reputation for financial stability and fair and honest dealings with customers. Credit unions or other depository institutions that have been or are currently customers of the dealer should be contacted. In addition, credit unions should also review information available from State or Federal securities regulators and securities industry self-regulatory organizations, such as the National

Association of Securities Dealers, concerning any formal enforcement actions against the dealer, its affiliates or associated personnel.

As part of the process of providing oversight over a credit union's relationships with securities dealers, the board of directors shall adopt a policy concerning conflicts of interest which addresses, at a minimum, when employees or family members of employees who are directly involved in purchasing and selling securities for the credit union are also engaging in personal securities transactions with these same securities firms.

K.S.A. 17-2204a(d) provides that a credit union's directors, officials, committee members and employees, and the immediate family members of those persons may not receive pecuniary consideration in connection with the making of an investment by the credit union. Accordingly, the board shall also adopt a policy applicable to directors, officers, employees, committee members and immediate family members for those individuals prohibiting or limiting the receipt of gifts, gratuities, or travel expenses from approved securities dealer firms and their personnel.

8. Investment Policies. Credit unions shall develop and keep current written investment policies and strategies.

An investment policy is a written description of authorized investment limitations and activities and the goals and objectives the institution expects to achieve through such activities. Investment limitations should address authorized investments and any limitations applicable to any Investment Security. The investment policy should also address the credit union's requirements or conditions for obtaining more than one price on an Investment Security or for a determination of market yield on comparable term investment. Where the nature of the credit union investment or the type of investment activity authorized by the board are complex, the investment policy should provide for the creation of and authority and duties for an Asset Liability Committee.

Strategies are written descriptions of the way management intends to achieve these goals and objectives and should address management's plans for each type of security (e.g., U.S. Treasuries, mortgage-backed securities, etc.) that will be used to carry out the investment policy. The investment policy and strategies should be consistent with the credit union's overall business plan.

Securities trading activity should only be conducted in a closely supervised trading account by credit unions with strong capital and earnings and adequate liquidity. Each credit union's investment policy and strategies must describe anticipated investment activities and either identify anticipated



trading and available for sale activities or state that the institution will not enter into any trading or available for sale activities.

If a credit union intends to or engages in “gains trading,” “when-issued” securities trading or “pair-offs,” as part of its authorized investment activity, such activity may only be conducted in a trading account. “Gains trading” is characterized by the purchase of a security and the subsequent sale of that same security at a profit after a short-term holding period. Frequent purchase and sale activity, combined with a short-term holding period for securities, clearly demonstrates management’s intent to profit from short-term price movements. “When-Issued” securities trading is the buying and selling of securities in the period between the announcement of an offering and the issuance and payment date of the securities. A purchaser of a “when-issued” security acquires all the risks and rewards of owning a security and may sell the “when-issued” security at a profit before having to take delivery and pay for it.

A “pair-off” is a security purchase transaction that is closed-out or sold at, or prior to, settlement date or expiration date. In a “pair-off,” a credit union will commit to purchase a security. Then, prior to the predetermined settlement date, the credit union will “pair-off” the purchase with a sale of the same security prior to, or on, the original settlement date. Profits or losses on the transactions are settled by one party to the transaction remitting to the counter-party the difference between the purchase and sale price. Like “when-issued” trading, “pair-offs” permit an institution to speculate on securities price movements without having to pay for the securities. The investment policy must specify any parameters on “gains trading,” “when-issued trading,” and “pair-offs” activity.

Securities activities must be conducted in a safe and sound manner. The board of directors should review and approve the overall investment policy and management’s documented strategies annually, or more frequently if appropriate, and these approvals must be adequately documented.

Furthermore, the board of directors or an appropriate committee thereof should review the credit union's securities activities and holdings no less than quarterly. The board of directors or an appropriate committee thereof should also oversee the establishment of appropriate systems and internal controls that are designed to ensure that securities activities and holdings are consistent with the strategies of the credit union and that the implementation of the strategies remains consistent with the investment policy’s objectives.

When developing its investment policy and strategies, a credit union should take into account such factors as asset/liabilities position, asset concentrations, interest rate risk, liquidity, credit risk, market volatility, and management’s capabilities and desired rate of return. If the board of

directors of a credit union fails to adopt policies and strategies related to securities or if a credit union fails to adhere to the policies and strategies approved by its board of directors, examiners may, among other things, determine that some or all securities are available for sale or held for trading and accounted for consistent with that classification.

In addition, the board of directors must ensure that the credit union's management has established appropriate procedures to obtain and maintain possession or control of securities purchased. In this regard, purchased securities should only be left in safekeeping with a safekeeping agent as specified in Section 5 of these guidelines. Credit unions, when entering into securities lending transactions or a repurchase agreement with a broker/dealer, are not permitted to maintain the collateral with the broker/dealer. Such collateral must be cash or Investment Securities and must be held by the credit union or a safekeeping agent as specified in Section 5 of these guidelines.

9. Unsuitable Investment Practices. The following activities are now deemed to be unacceptable practices for credit unions in the purchase or sale of Investment Securities and raise supervisory concerns with respect to the safety and soundness of a credit union engaging in any of these activities:

- a. Extended Settlements. Regular-way settlement for transactions in U.S. Government and Federal agency securities, including U.S. Treasury strips (other than mortgage-backed and derivative products) is one business day after the trade date. Regular-way settlement for municipal securities is five business days after the trade date. In addition, regular-way settlement for transactions in mortgage backed and mortgage derivative products varies and can be up to 45 to 60 days after the trade date.

The use of an extended settlement method for U.S. Government securities purchases appears to be offered by securities dealers in order to facilitate speculation on the part of the purchaser, similar to the profit opportunities available in a "pair-off" transaction. The use of a settlement period in excess of the regular-way settlement period appropriate for an instrument and in the case of mortgage backed and mortgage derivative products, 60 days is not authorized.

- b. Repositioning Repurchase Agreements. The repositioning repurchase agreement is a service provided by the dealer so the buyer can hold the speculative position until it can be sold at a gain. The buyer purchasing the security pays the dealer a small "margin" that approximates the actual loss in the security. The dealer then agrees to fund the purchase of the security by buying it back from the purchaser under a resale agreement. Any dealer financing technique such as a repositioning repurchase

agreement that is used to fund the speculative purchase of securities may be indicative of securities that were acquired with the intent to resell at a profit at or prior to settlement or after a short-term holding period. This activity is inherently speculative and is a wholly unsuitable investment practice for credit unions.

In addition, credit unions are prohibited from participating directly or indirectly in (1) the purchase or sale of a standby commitment; (2) a futures contract; (3) adjusted trading; or (4) the short sale of a security.

10. In the case of inconsistencies between the conditions established in Sections 3 through 7 of these Investment Guidelines, such inconsistencies or ambiguities shall be resolved by complying with the most restrictive of such conditions.